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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Commissioner James H. Quello
Federal Communications Commission
1919 M Street, N.W., Room 802
Washington, D.C. 20554

Re: In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1; Comments of BellSouth

Dear Commissioner Quello:

Today BellSouth Telecommunications, Inc. ("BellSouth") is submitting the attached Comments in response to the Commission's comprehensive performance review of the Commission's price cap plan for local exchange carriers ("LECs") in CC Docket No. 94-1. These Comments set forth BellSouth's proposed revisions to the LEC plan -- revisions that are intended to improve the plan's performance, and on a broader level, to advance the shared priority of the Clinton Administration, the Congress, and the Commission to promote the rapid development and deployment of a National Information Infrastructure ("NII").

The Clinton Administration has urged that the NII be accompanied by a new, flexible telecommunications regulatory regime that will facilitate greater economic growth by removing regulatory barriers and will create new jobs, new business opportunities and expanded diversity of choice for American consumers. Four years ago, the Commission anticipated this visionary call for telecommunications regulatory reform by fundamentally redefining the method by which AT&T and the largest LECs are regulated. The Commission took major steps to replace most of its traditional rate-of-return or "cost-plus" system of regulation with the incentive-based system of price caps.

The attached Comments are framed around BellSouth's overall conclusion that the Commission's LEC price cap plan to date has been an important first step -- but only a **qualified** success -- in promoting the regulatory vision that will truly maximize LEC contributions to economic growth, infrastructure development and the creation of jobs for American workers. The economic experience and performance of the price cap LECs in general and of BellSouth in particular under the Commission's price cap regime support the Commission's basic policy judgment, articulated in the LEC Price Cap Order, that a properly-designed system of incentive regulation is superior to a rate-of-return-based regime and generates greater consumer benefits.

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Nevertheless, BellSouth also believes strongly that the Commission's current regulatory structure -- which is not yet a "pure" price cap plan but an interim hybrid of direct price and rate-of-return regulation -- can and must be modified in several important ways if the public interest goals of price cap regulation, including the deployment of the NII, are to be fully realized.

The Commission has presented twelve general "Baseline" categories for comment regarding potential changes to its core LEC price cap regulatory regime, and six "Transition" issues for comment relating to the adaptation of the LEC price cap plan in response to competitive market developments. In response to the Commission's baseline issues, BellSouth recommends several specific, affirmative changes to the price cap rules that will significantly improve the performance of the overall LEC plan. These baseline changes include:

- **Elimination of sharing and low end adjustment mechanisms** --

  BellSouth believes that it is imperative for the Commission to eliminate the sharing and low-end adjustment mechanisms. These devices are interim safeguards that were never intended to be long-term features of the LEC price cap plan, are no longer warranted, and perpetuate administrative complexity and perverse rate-of-return incentives that are fundamentally incompatible with price regulation.

- **Lowering of the Productivity Offset** --

  A recent Total Factor Productivity (TFP) study performed by Christensen Associates undertaken on behalf of the United States Telephone Association suggests that the baseline productivity offset for price cap LECs initially chosen by the Commission in fact has proven to be too high. Measuring from the time of the AT&T divestiture (1984) through the first two years of price caps (1992), the Christensen study calculates that the growth differential between the LECs and the most comprehensive TFP measure published by the Bureau of Labor Statistics has been **1.7 percent**. Even adding in the 0.5 percent Consumer Productivity Dividend ("CPD"), the Christensen result suggests that the LEC productivity offset should be reduced over a full percentage point from the Commission's 1990 estimate.

- **Modification of rules governing the introduction of new services** --

  BellSouth urges the Commission to reform the detailed cost and engineering support requirements associated with the introduction of new services in order to encourage price cap LECs to develop and introduce innovative new services.

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- **Revision of the LEC price cap basket and banding structure** --

  Building upon the recent changes in the basket structure adopted by the Commission in connection with its restructuring of local transport rates, BellSouth proposes to eliminate those price cap constraints which serve no legitimate regulatory purpose, but instead only interfere with the efficiencies and incentives that price caps are intended to create.

These proposed baseline modifications to the price cap rules are necessary to improve the performance of the LEC plan and will ensure that the plan continues to achieve the Commission's expansive public policy objectives. BellSouth requests that the Commission afford baseline price cap changes the highest priority, and implement them no later than January 1, 1995.

In addition, the attached Comments set forth BellSouth's position that in view of the dramatic changes taking place in telecommunications technology and markets, the LEC price cap plan must be modified and positioned to accommodate rapidly emerging competition in the local exchange marketplace. In response to the transition issues raised by the Commission, BellSouth provides specific and detailed data on competition in BellSouth service areas, and proposes a transition framework which relaxes regulation commensurate with the presence of competition.

In a speech last week, Chairman Hundt remarked that "[i]n building our communications networks, no other country in the world is trusting in private industry and competition to the degree we are."[1/] This observation captures the essence of the theory of price cap regulation. The Commission's trust in private industry to build the NII will be well-placed if the Commission provides the appropriate incentives and regulatory flexibility necessary to realize the goal.

Very truly yours,

David J. Markey
BELLSOUTH CORPORATION

Enclosure
cc: Willam F. Caton, Secretary

1/ Address of Chairman Reed E. Hundt to the National Press Club (May 2, 1994).